

## Message Text

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PAGE 01 LONDON 05180 01 OF 03 292101Z  
ACTION EUR-12

INFO OCT-01 EA-07 NEA-10 IO-13 ISO-00 SP-02 USIA-06  
AID-05 EB-08 NSC-05 SS-15 STR-04 OMB-01 CEA-01  
CIAE-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03  
LAB-04 SIL-01 ACDA-07 IGA-02 ITC-01 AGRE-00  
EURE-00 /120 W  
-----292128Z 034076 /41

P R 292139Z MAR 77  
FM AMEMBASSY LONDON  
TO SECSTATE WASHDC PRIORITY 2081  
TREASURY DEPT WASHDC PRIORITY  
INFO AMEMBASSY BONN  
AMEMBASSY BRUSSELS  
AMEMBASSY DUBLIN  
AMEMBASSY NEW DELHI  
AMEMBASSY PARIS  
AMEMBASSY ROME  
AMEMBASSY TOKYO  
AMCONSUL BELFAST  
AMCONSUL EDINBURGH  
USMISSION EC BRUSSELS  
USMISSION OECD PARIS  
USDEL MTN GENEVA  
USDOC WASHDC

LIMITED OFFICIAL USE SECTION 01 OF 03 LONDON 05180

DEPARTMENT PASS FEDERAL RESERVE BOARD

TREASURY FOR DONALD E. SYVRUD, OASIA

E.O. 11652: N/A  
TAGS: EFIN, UK  
SUBJECT: AN OVERVIEW OF THE CHANCELLOR'S MARCH 29  
BUDGET  
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PAGE 02 LONDON 05180 01 OF 03 292101Z

SUMMARY: CHANCELLOR HEALEY'S BUDGET CONTAINED NO MAJOR  
SURPRISES. IN SOME WAYS IT WAS CAUTIOUS WITH THE CHAN-  
CELLOR HOLDING THE CARDS CLOSE TO HIS CHEST. THE BUDGET  
IS A MAJOR BARGAINING DOCUMENT, THE CHANCELLOR AGAIN  
OFFERING A MAJOR SWEETENER TO THE TRADE UNIONS IN THE  
FORM OF CONDITIONAL TAX REDUCTIONS OF ABOUT 1 BILLION

POUNDS IN RETURN FOR A SATISFACTORY PAY AGREEMENT. HE DID NOT DEFINE WHAT A SATISFACTORY THIRD ROUND OF INCOMES POLICY WOULD BE.

THERE WERE NO INCREASES IN VAT WHICH WOULD HAVE CAUSED IMMEDIATE INCREASES IN RETAIL PRICES, BUT HE DID INCREASE EXCISE TAXES BY 800 MILLION POUNDS ON CIGARETTES, GASOLINE AND MOTOR VEHICLE REGISTRATION. IN RETURN, HE ANNOUNCED UNCONDITIONAL TAX CUTS OF 1,350 MILLION POUNDS WITH SOME BENEFITS GOING TO ALL EARNING CATEGORIES. HE ALSO ANNOUNCED CONTINUATION OR CREATION OF VARIOUS EMPLOYMENT SCHEMES.

THE CHANCELLOR CITED THE ECONOMIC PROGRESS MADE BY THE UK SINCE LAST DECEMBER. IN REVIEWING THE WORLD ECONOMY, HE SAID THAT THE U.S. AND JAPAN WERE MAKING EFFORTS TO EXPAND THEIR ECONOMIES, BUT PERHAPS MORE COULD BE DONE IN THE EC. LOOKING AHEAD, UK ECONOMIC GROWTH WILL BE SLOW DURING THE NEXT 12 MONTHS (ABOUT 1-1/2 PERCENT) WITH HOPES OF INFLATION FALLING TO ABOUT 13 PERCENT BY YEAR END AND TO SINGLE FIGURES BY 2ND QUARTER OF 1978. THE BALANCE OF PAYMENTS WILL SHOW STEADY IMPROVEMENT. THERE WAS NOTHING IN THE MESSAGE THAT SHOULD CAUSE TROUBLE FOR THE IMF. HEALEY STRESSED THAT IMF TARGETS WOULD BE MET. HE SAID HE WOULD BE PRESSING FOR GREATER WORLD EXPANSION IN THE APRIL IMF INTERIM COMMITTEE AND AT THE MAY SUMMIT MEETINGS.

THE BUDGET MUST BE SEEN AS A HIGHLY POLITICAL DOCUMENT, AIMED AT INDUCING THE TRADE UNIONS TO ADHERE TO A SATISFACTORY THIRD PHASE OF INCOMES POLICY. ITS SUCCESS WILL DEPEND ON THE UNIONS' REACTION. THE CONSERVATIVES LIMITED OFFICIAL USE

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PAGE 03 LONDON 05180 01 OF 03 292101Z

HAVE ATTACKED THE BUDGET--AS THEY DID LAST YEAR--FOR THE CONDITIONAL NATURE OF ITS TAX CUTS. THE FOREIGN EXCHANGE MARKET REACTED IN A CAUTIOUSLY APPROVING WAY. SEPARATE MESSAGES REPORT AT LENGTH ON THE DETAILS OF THE CHANCELLOR'S BUDGET PROPOSALS, INCLUDING EXCISE TAX INCREASES AND DIRECT TAX CUTS, ON THE ECONOMIC FORECASTS ACCOMPANYING THE BUDGET, AND ON A CHANGE IN EXCHANGE CONTROLS. END SUMMARY.

1. THE CHANCELLOR SPOKE FOR ABOUT 1 HOUR AND 20 MINUTES SIPPING FROM A GLASS OF AMBER COLORED LIQUID AS HE USUALLY DOES. HE STRESSED THE NEED TO BRING DOWN INFLATION AND IMPROVE INDUSTRIAL PERFORMANCE, SAYING THIS IS THE ONLY WAY TO CREATE MORE JOBS AND RAISE LIVING STANDARDS WITHOUT GOING BACK INTO A CYCLE OF FINANCIAL CRISES, RUNS ON THE POUND AND MORE FOREIGN BORROWING. LAST DECEMBER'S MEASURES RESTORED FINANCIAL STABILITY. FIRM CONTROL OF PUBLIC SPENDING AND MONEY SUPPLY WILL MAINTAIN IT. A FURTHER SUCCESSFUL ROUND OF PAY POLICY IS ESSEN-

TIAL NOT ONLY TO CUT INFLATION DIRECTLY BUT ALSO TO HELP  
SUPPORT THE EXCHANGE RATE.

2. HEALEY EXPLAINED IF BRITISH PRICES RISE MORE THAN  
THE UK COMPETITORS'. THE POUND FALLS, RAISING  
IMPORT PRICES, LEADING TO HIGHER PRICES IN THE SHOPS AND  
IN TURN TO HIGHER WAGE INCREASES WHICH IN TURN BRING MORE  
INFLATION. THERE IS HOWEVER, A REAL CHANCE TO BREAK OUT

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PAGE 01 LONDON 05180 02 OF 03 292057Z  
ACTION EUR-12

INFO OCT-01 EA-07 NEA-10 IO-13 ISO-00 SP-02 USIA-06  
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CIAE-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03  
LAB-04 SIL-01 ACDA-07 IGA-02 ITC-01 AGRE-00  
EURE-00 /120 W

-----292129Z 033860 /41

P R 292139Z MAR 77  
FM AMEMBASSY LONDON  
TO SECSTATE WASHDC PRIORITY 2082  
TREASURY DEPT WASHDC PRIORITY  
INFO AMEMBASSY BONN  
AMEMBASSY BRUSSELS  
AMEMBASSY DUBLIN  
AMEMBASSY NEW DELHI  
AMEMBASSY PARIS  
AMEMBASSY ROME  
AMEMBASSY TOKYO  
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LIMITED OFFICIAL USE SECTION 02 OF 03 LONDON 05180

OF THIS VICIOUS CYCLE, ATTAIN THE TUC'S OWN TARGET OF  
SINGLE FIGURE INFLATION BY THE 2ND QUARTER OF 1978 AND  
END THE DECLINE IN LIVING STANDARDS. BOTH PAY

POLICY AND INDUSTRIAL STRATEGY ARE THEREFORE VITAL  
NATIONAL NEEDS IN CURBING INFLATION, INCREASING UK SHARE  
OF WORLD MARKETS AND MAINTAINING THE VALUE OF THE POUND.  
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PAGE 02 LONDON 05180 02 OF 03 292057Z

3. THE CHANCELLOR INDICATED AS HIS MAIN BUDGET AIMS  
PREPARING THE WAY FOR A NEW PAY AGREEMENT; GIVING MORE  
WORK INCENTIVES AND EASING TAX BURDENS; EXPANDING THE  
ECONOMY AS FAR AS PRUDENT, BUT ERRING ON THE SIDE OF  
CAUTION, IN PART BECAUSE OF THE UNCERTAIN NEAR-TERM BAL-  
ANCE OF PAYMENTS PATH; AVOIDING UNNECESSARY PRICE  
CHANGES; AND GIVING MORE DIRECT HELP TO THOSE HIT HARDEST  
BY RECESSION. IN ADDITION, HIS EXCISE TAX INCREASES  
WOULD HAVE AS ANCILLARY AIMS ENERGY SAVING AND HEALTH.  
EXPLAINING THE EXPECTED PSBR FOR FY76-77 WOULD BE 8.8  
BILLION POUNDS, CONSIDERABLY BELOW THE 11.2 BILLION  
ESTIMATED IN DECEMBER, HE SAW FY77-78 PSBR AT ABOUT  
7.5 BILLION, ROUGHLY 1.2 BILLION POUNDS BELOW THE FIGURE  
ESTIMATED IN DECEMBER AND MENTIONED IN THE IMF LETTER.  
THERE IS THEREFORE SCOPE FOR TAX CHANGES.

4. HEALEY OUTLINED IMMEDIATE PROPOSED TAX CHANGES AS  
FOLLOWS. AN INDIRECT TAX INCREASE OF 800 MILLION POUNDS  
COUPLED WITH A GROSS 1.35 BILLION CUT IN INCOME TAX WOULD  
GIVE A NEEDED BOOST TO THE ECONOMY OF ABOUT 500 MILLION  
POUNDS. WHEN A SATISFACTORY PAY AGREEMENT IS REACHED,  
AN EXTRA 1 BILLION POUND CUT IN INCOME TAX WOULD BE MADE  
BRINGING THE TOTAL INCOME TAX CUT TO 2.31 BILLION POUNDS  
WITH A TOTAL NET BOOST TO THE ECONOMY OF 1.5 BILLION  
POUNDS. THE TOTAL POSITIVE IMPACT ON GDP WOULD ADD AB-  
OUT 1/2 PERCENT TO GDP IN THE NEXT 12 MONTHS AND ABOUT  
3/4 PERCENT BY THE END OF 1978.

5. AT THE SAME TIME, THE CHANCELLOR ANNOUNCED MEASURES  
TO HELP THOSE HARDEST HIT BY THE WEAK ECONOMY BY JOB  
CREATION AND MAINTENANCE PROGRAMS, ALTHOUGH THE MONEY  
USED WOULD NOT INCREASE PUBLIC EXPENDITURE, BUT RATHER  
COME FROM THE CONTINGENCY RESERVE AND EXISTING PROGRAMS.  
IN ADDITION, A 100 MILLION POUND CONSTRUCTION PROGRAM  
FOR THE INNER CITIES WAS ANNOUNCED. TOTAL EFFECT ON JOBS  
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PAGE 03 LONDON 05180 02 OF 03 292057Z

OF THE EXPENDITURE MEASURES WOULD BE TO INCREASE EMPLOY-  
MENT BY 150 THOUSAND. THE TAX MEASURES ARE EXPECTED TO  
INCREASE EMPLOYMENT BY UP TO AN ADDITIONAL 100 THOUSAND.

6. THE CHANCELLOR'S ECONOMIC OUTLOOK SHOWED WEAK GDP GROWTH FROM THE FIRST HALF OF 1977 TO THE FIRST HALF OF 1978 (1-1/2 PERCENT) WITH EXPORTS OF GOODS AND SERVICES (UP 5-1/2 PERCENT) AND MANUFACTURING INVESTMENT (UP 17-1/2 PERCENT) PROVIDING THE STIMULUS. NO UPTURN IS FORESEEN IN INVENTORIES. IMPORTS OF GOODS AND SERVICES ARE EXPECTED TO GROW AT 2 PERCENT, MANUFACTURING PRODUCTION TO INCREASE 2-1/2 PERCENT. THE BALANCE OF PAYMENTS WOULD BE IN ROUGHLY 500 MILLION POUND DEFICIT IN 1977 GOING INTO A 500 MILLION POUND SURPLUS IN THE FIRST HALF OF 1978.

7. COMMENT: COMPARED TO PREVIOUS BUDGETS THE HOUSE WAS FAIRLY SUBDUED DURING HEALEY'S PRESENTATION. HIS FAILURE TO INCREASE VAT TOOK SOME BY SURPRISE. HIS ELABORATION OF THE NET IMPACT TO INDIVIDUAL TAXPAYERS OF THE PROPOSED TAX CUTS, IN RETURN FOR A SATISFACTORY PAY DEAL WERE PARTLY INCOMPREHENSIBLE. THE MAIN POINT IS THAT HE HAS OFFERED THE TRADE UNIONS A SUBSTANTIAL INCENTIVE WHICH HAS THE EFFECT OF HELPING TO RESTORE DIFFERENTIALS IN NET INCOME AFTER TAX AND TO REDUCE THE POVERTY TRAP. VERY LITTLE WAS DONE FOR THOSE IN THE TOP INCOME BRACKETS. HEALEY HAS GIVEN HIMSELF A FAIR AMOUNT OF ROOM TO MANEUVER BY NOT DEFINING WHAT A SATISFACTORY PAY DEAL WOULD BE. THIS WAS OPPOSITION LEADER MARGARET THATCHER'S MAIN POINT IN REBUTTAL TO THE CHANCELLOR. THE SUCCESS OF HEALEY'S GAMBIT WILL DEPEND ON THE TUC'S REACTION. A KEY QUESTION IS IF THE TUC CANNOT DELIVER A MODERATE STAGE 3, WILL HEALEY HAVE THE GUTS NOT TO MAKE THE CONDITIONAL TAX CUTS.

8. IT WAS EXPECTED THAT HEALEY WOULD CITE ECONOMIC LIMITED OFFICIAL USE

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PAGE 04 LONDON 05180 02 OF 03 292057Z

AND FINANCIAL PROGRESS MADE SINCE LAST DECEMBER ALTHOUGH ON THIS POINT TOO, MRS. THATCHER COMMENTED SHARPLY THAT POOR CONTROL OF MONETARY AGGREGATES AND DEBT MANAGEMENT LAST AUGUST AND SEPTEMBER LED TO THE POUND'S SHARP DECLINE IN OCTOBER.

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PAGE 01 LONDON 05180 03 OF 03 292102Z  
ACTION EUR-12

INFO OCT-01 EA-07 NEA-10 IO-13 ISO-00 SP-02 USIA-06  
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CIAE-00 FRB-03 INR-07 NSAE-00 XMB-02 OPIC-03  
LAB-04 SIL-01 ACDA-07 IGA-02 ITC-01 AGRE-00  
EURE-00 /120 W

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P R 292139Z MAR 77  
FM AMEMBASSY LONDON  
TO SECSTATE WASHDC PRIORITY 2083  
TREASURY DEPT WASHDC PRIORITY  
INFO AMEMBASSY BONN  
AMEMBASSY BRUSSELS  
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LIMITED OFFICIAL USE SECTION 03 OF 03 LONDON 05180

9. LOOKING AHEAD, HEALEY'S CALL FOR GREATER EFFORTS TO  
BE MADE BY THOSE COUNTRIES IN STRONGER POSITIONS IS NOT  
NEW, ALTHOUGH HE DID SAY HE WOULD BE REPEATING THE ARGU-  
MENT AT THE APRIL INTERIM COMMITTEE SESSION AND AT THE  
MAY SUMMIT. AT ONE POINT HEALEY SAID, "IF THE STRONGER  
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PAGE 02 LONDON 05180 03 OF 03 292102Z

ECONOMIES INCREASE DOMESTIC DEMAND AND REDUCE THEIR  
EXTERNAL SURPLUSES, THEY WOULD HELP GREATLY TO SUSTAIN  
ACTIVITY IN THE WORLD AS A WHOLE. PRESIDENT CARTER HAS  
RECENTLY GIVEN HIS SUPPORT TO THE VIEWS OF THE OECD AND  
IMF IN THIS REGARD. ON THE OTHER HAND COUNTRIES WITH  
HIGHER INFLATION RATES AND WEAKER BALANCE OF PAYMENTS  
POSITIONS FACE MORE PAINFUL ADJUSTMENTS. THEY WILL NEED

TIME TO ADJUST THEIR ECONOMIES TO THE MANY SHOCKS THEY HAVE SUFFERED OVER THE LAST FEW YEARS. IN PARTICULAR THEY WILL NEED ACCESS TO ADEQUATE FINANCE ON APPROPRIATE TERMS SO THAT THEY ARE NEITHER FORCED UNNECESSARILY TO DEFLATE THEIR ECONOMIES NOR TEMPTED INTO TRADE RESTRICTIONS -- EITHER OF THESE COURSES WOULD BE DAMAGING TO THE WORLD AS A WHOLE. THIS WILL BE A MAJOR TOPIC AT THE MEETING OF THE INTERIM COMMITTEE OF THE IMF IN WASHINGTON NEXT MONTH."

10. STERLING RESPONDED POSITIVELY TO THE BUDGET, ACCORDING TO SOME FOREIGN EXCHANGE OPERATORS BECAUSE OF THE BETTER THAN EXPECTED OUTCOME OF PSBR AND THE CHANCELLOR'S --THUS FAR AT LEAST -- CAUTIOUS APPROACH TOWARDS REFLATING THE ECONOMY.  
SPIERS

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## Message Attributes

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**TAGS:** EFIN, UK, (HEALEY, DENIS)  
**To:** STATE TRSY  
**Type:** TE  
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